TRUST LAND MANAGEMENT DIVISION

(LEFT / RIGHT) HOYT RICHARDS

(LEFT) BOB VLAHOVICH
(RIGHT) BOB RICH

PHOTO BY DAN BUSHNELL

TRUST LAND MANAGEMENT DIVISION

Manage the State of Montana's trust land resources to produce revenues for the trust beneficiaries while considering environmental factors and protecting the future income-generating capacity of the land.

Overview

General background information on the Trust Land Management Division (TLMD) is available on the department's website:

www.dnrc.state.mt.us/trust/tlmdhome.htm

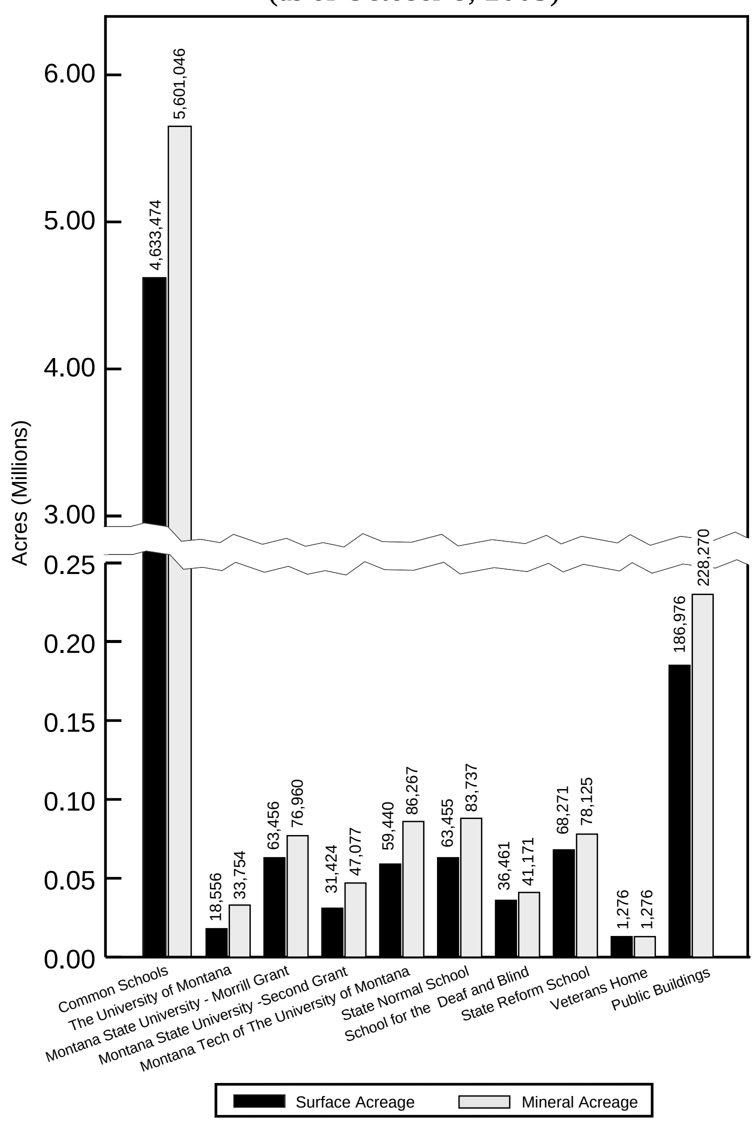
History

By the Enabling Act approved February 22, 1889, the Congress of the United States granted to the State of Montana, for common school support, sections sixteen and thirty-six in every township within the state. Some of these sections had been homesteaded, some were within the boundaries of Indian reservations, and yet others had been otherwise disposed of before passage of the Enabling Act. To make up for this loss, and in lieu thereof, other lands were selected by the State of Montana.

The Enabling Act and subsequent acts also granted acreage for other educational and state institutions, in addition to the common schools. The original common school grant was for 5,188,000 acres. The additional acreage provided for other endowed institutions included 668,720 acres, for a total of 5,856,720 acres. The total acreage figure (see Figure 18) fluctuates through the years due to land sales and acquisitions. Mineral acreage now exceeds surface acreage because the mineral estate has been retained when lands are sold. Surface acreage at the end of FY 2003 totals over 5.1 million acres; mineral acreage exceeds 6.2 million acres.

The trust land management program has been returning revenues averaging $35.7 million to the school trusts over each of the past five years. Those revenues have been obtained through an average annual expenditure of $6 million. Therefore, the ratio of dollars returned to dollars expended is 5.9 to 1.

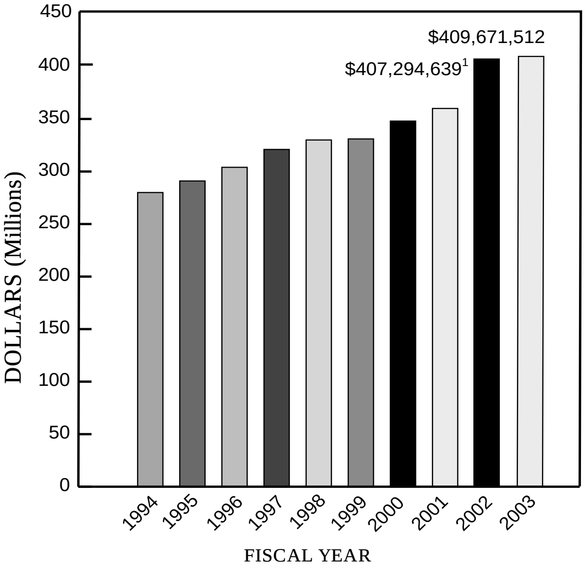
Figure 18. Current Land Ownership
(as of October 8, 2003)



The Permanent Fund

The Enabling Act provided that proceeds from the sale and permanent disposition of any of the trust lands, or part thereof, shall constitute permanent funds

Figure 19. Permanent Fund Balance



1. The Fiscal Year 2002 total includes $46.4 million in coal trust loan proceeds, pursuant to Senate Bill 495 (2001 Legislature).

for the support and maintenance of the public schools and the various state institutions for which the lands had been granted. The Montana Constitution provides that these permanent funds shall forever remain inviolate, guaranteed by the State of Montana against loss or diversion. These funds are often referred to as "nondistributable."

The program generated over $4 million in nondistributable revenue in FY 2003, which was offset by trust administration expenses of over $3.9 million. The net revenue resulted in a balance of over $409 million in the combined permanent funds. The permanent trust balance is shown in Figure 19; Table 24 shows nondistributable receipts for trust revenue for FY 2003 and the current balance of each permanent trust fund.

Table 24
Revenue Generated for the Trusts and Permanent Fund Balances in Fiscal Year 2003

Trust	Distributable Revenue	Permanent Fund (Nondistributable Revenue)		
	2003 Revenue	2003 Revenue	2003 TAC Expenses[1]	Current Balance[2]
Common Schools	$43,672,110	$2,355,861	$3,669,482	$381,058,565
Other Trusts The University of Montana	192,587	17,496	3,538	1,495,503
Montana State University-Morrill Grant	347,154	85,514	0	2,984,782
Montana State University-Second Grant	836,822	768,110	74,467	8,111,574
Montana Tech of The University of Montana	677,348	712,025	34,762	4,527,556
State Normal School	562,775	234,968	61,247	5,852,146
School for the Deaf and Blind	282,040	168,447	30,578	2,869,965
State Reform School (Pine Hills)	348,803	154,777	23,837	2,754,679
Veterans Home	6,759	0	0	16,742
Public Buildings	771,933	NA	85,162	NA
TOTALS	$47,698,331	$4,497,198	$3,983,073	$409,671,512

1. Trust Administration Account (TAC) expenditures.
2. Trust balances reflect deposit activity by DNRC only, and do not include valuation adjustments from investment activities by the Board of Investments.

Interest and Income

The Enabling Act further provided that rentals received on leased lands, interest earned on the permanent funds arising from these lands, interest earned on deferred payments on lands sold, and all other actual income shall be available for the maintenance and support of such schools and institutions. These funds are referred to as "distributable." The Trust Land Management Division distributed over $47 million in earnings and interest directly to the public schools and other entities in FY 2003. Receipts for FY 2003 trust revenue are detailed in Table 24.

The Montana Board of Investments manages the investments of the permanent fund on behalf of the trust beneficiaries. This fund is also referred to as the Trust and Legacy Fund. The board's management tenets are expressed in the following excerpt.

> *History - Article X, Sections 2 and 3 of the state Constitution requires that all royalties and other proceeds received from school lands granted to the state under federal enabling legislation be deposited in the Trust and Legacy Fund, where it shall forever remain inviolate and guaranteed by the state against loss or diversion.*
>
> ### *Investment Objective/Constraints*
>
> - *Long-term, tax-exempt account with a time horizon well beyond normal market cycles.*
> - *Constitution does not permit equity investments.*
> - *Low liquidity requirements, except for investment purposes.*
> - *Current income is important because 95 percent of income is appropriated by the Legislature.*
> - *Broadly diversified portfolio of fixed-income securities, producing a total rate of return exceeding the Lehman Brothers Aggregate Bond Index over a five-year rolling period.*
>
> ... Montana Board of Investments, *Fiscal Year 2002 Annual Report,* Helena, Montana, p. 41.

Distribution of Revenues

Each section of state trust land is assigned to a specific trust. Distribution of revenues is handled in three different ways, as explained in the following subsections, depending on the section of trust land that generated the revenue.

The Trust Land Management Division also utilizes some general fund dollars to administer land for some other state agencies, in addition to state trust land. Revenue generated from that land is transferred directly to the state agency.

The Trust Land Management Division is funded predominantly by a combination of trust revenues.

Common School Trust

The distribution of revenues generated from common school trust land is illustrated in Figure 20. From the distributable receipts, a small percentage is used to fund the Resource Development Account and the Timber Sale Account. Ninety-five percent of the remaining distributable revenue is distributed yearly to the state Guarantee Account for use by the public schools of the state. The other 5 percent, together with nondistributable revenue, comprise the Permanent Fund. The interest earned on the Permanent Fund is also distributed to the Guarantee Account for use by the public schools, with the exception of 5 percent, which is returned to the Permanent Fund for reinvestment.

Trusts Other Than the Common School Trust

Distribution of revenues to the other trusts is similar (see Figure 21). A small percentage goes to the Resource Development Account, but no funds go to the State Timber Sale Account. All of the remaining distributable receipts go directly to the trust recipient. Included in "other" trusts are:

- The University of Montana
- Montana State University - Morrill Grant
- Montana State University - Second Grant
- Montana Tech of The University of Montana
- State Normal School (Montana State University-Billings and Western Montana College of The University of Montana)
- School for the Deaf and Blind
- State Reform School (Pine Hills)
- Veterans Home

Public Buildings

Distribution of revenues on public buildings trust land is similar. There is no permanent fund, however, so remaining distributable receipts go to the Department of Administration.

Purpose

The purpose of the Trust Land Management Division is to administer and manage the state trust timber, surface, and mineral resources for the benefit of the common schools and the other endowed institutions in Montana, under the direction of the Board of Land Commissioners. The board, which is often called the "State Land Board," consists of Montana's top elected officials:

Judy Martz, Governor

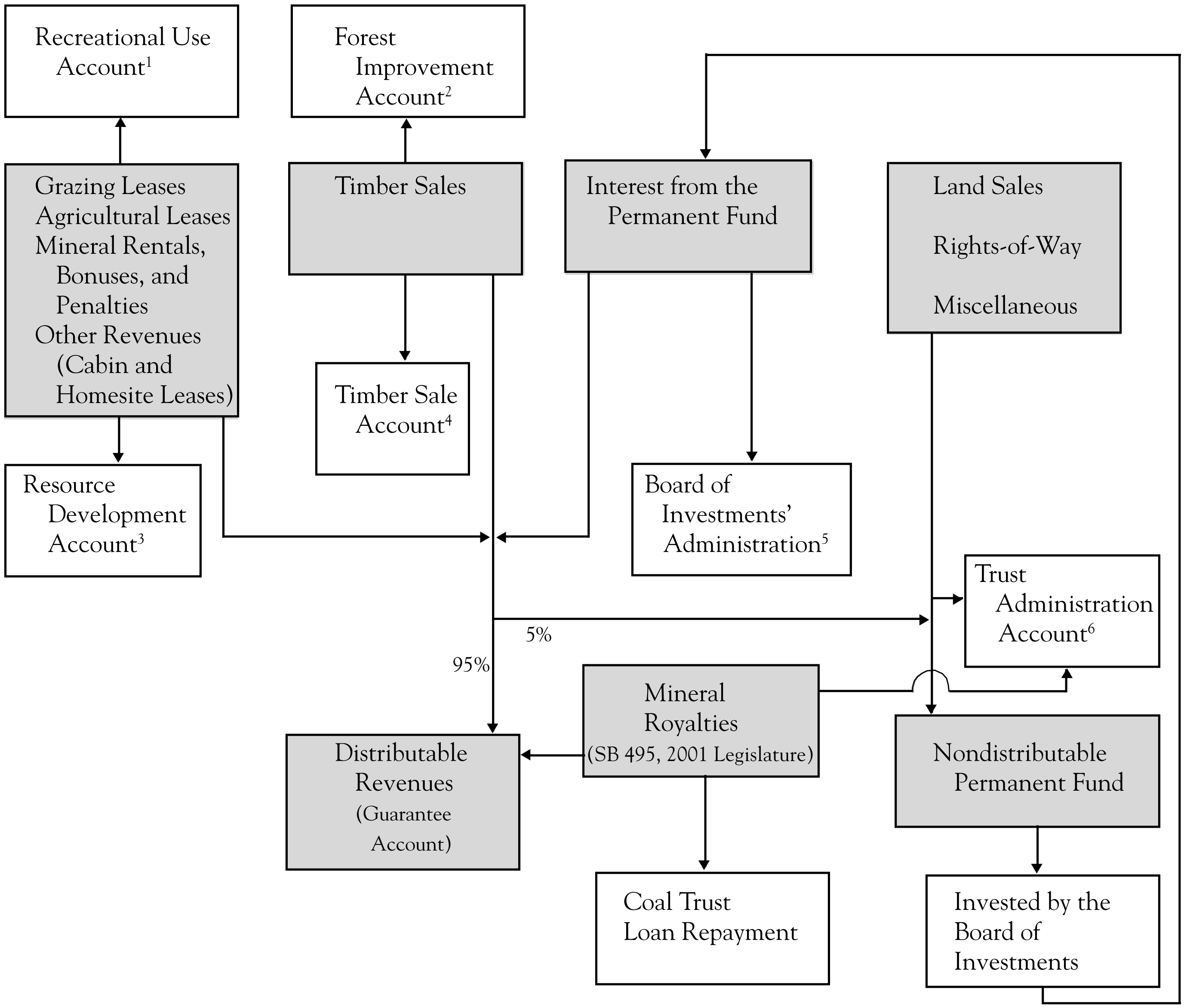
Bob Brown, Secretary of State

Linda McCulloch, Superintendent of Public Instruction

Mike McGrath, Attorney General

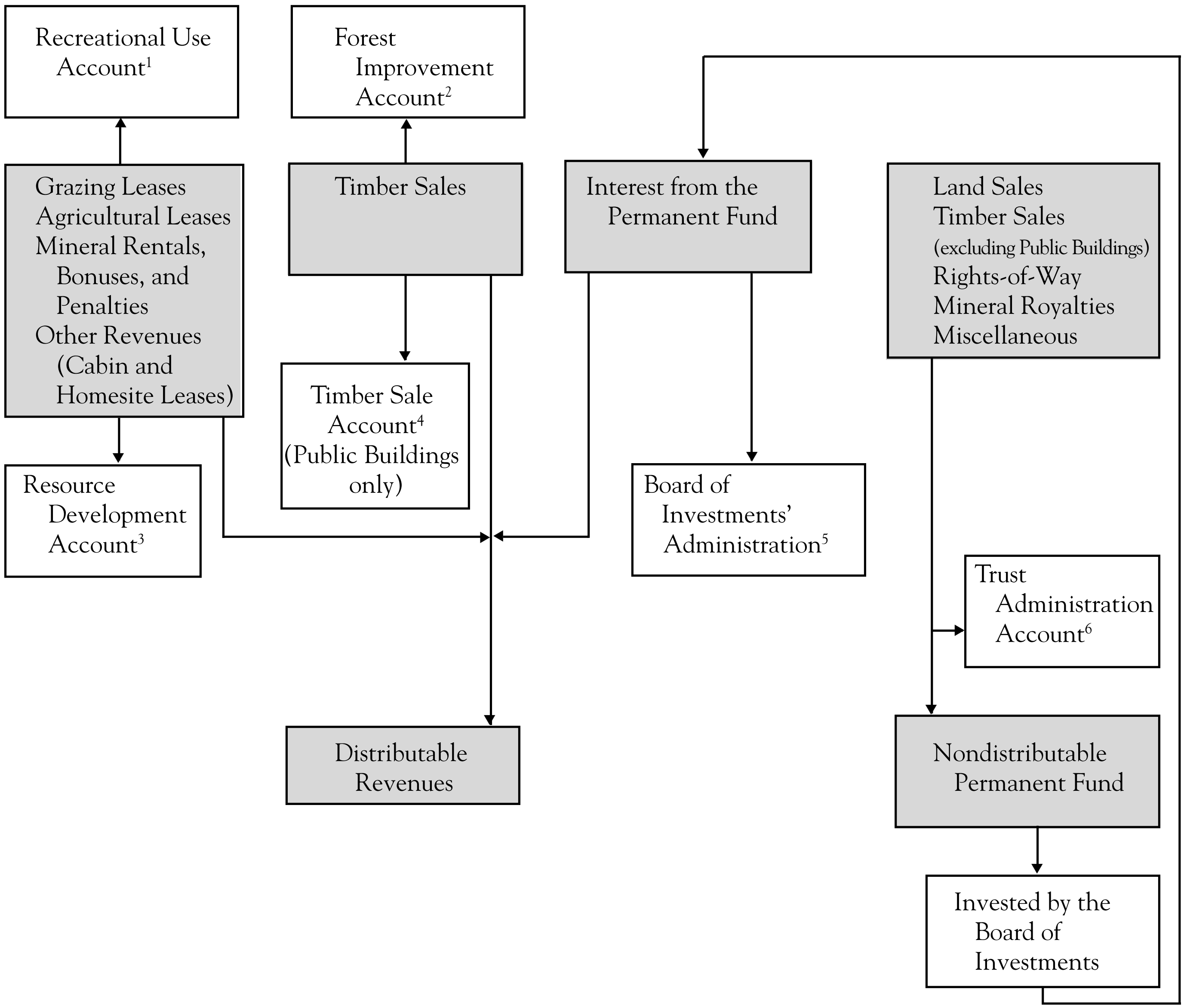
John Morrison, State Auditor

Figure 20. Distribution of Revenues from Common School Trust Lands



1. The Recreational Use Account is funded from a portion of each General Recreational Use License sold. (During FY 2003, $49,315 was spent by TLMD.)
2. The Forest Improvement Account is funded by additional fees assessed on individual timber sales. (During FY 2003, $1,000,585 was spent by TLMD.)
3. The Resource Development Account is limited to 3 percent of the distributable receipts excluding timber sale income. The purpose of the account is to invest in improving and developing state trust lands in order to increase the income-producing capacity of the lands. (During FY 2003, $521,622 was spent by TLMD.)
4. The State Timber Sale Account, comprised of timber sale revenue, contains that amount appropriated by the legislature each year to be used specifically for timber sale preparation and documentation. (During FY 2003, $2,424,074 was spent by TLMD.)
5. The Board of Investments' administration of the Permanent Fund is funded by a portion of the annual interest generated from those funds.
6. The Trust Administration Account was enacted by the 1999 Legislature. This funding utilizes part of the current year revenues. (During FY 2003, $3,908,496 was spent by TLMD.)

Figure 21. Distribution of Revenues from Other Trusts (Excluding Common School)



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The division is divided into four primary programs: agriculture and grazing management, forest management, minerals management, and special use management. Program administration, direction, oversight, and support are provided by staff and program specialists located in Helena and Missoula. On-the-ground management is provided by field personnel located throughout the state.

The department's obligation is to obtain the greatest benefit for the school trusts pursuant to MCA 77-1-202. The greatest monetary return must be weighed against the long-term productivity of the land to ensure continued future returns to the trusts. Total gross revenues generated by the Trust Land Management Division over the last five years are listed by activity in Table 25. This table contains not only trust revenues, but also those revenues collected for other state entities, revenues appropriated to fund a portion of the division's programs, and other miscellaneous revenues collected by the division.

Return on Asset Value Report

Senate Bill 411, passed by the 1999 Legislature and codified at MCA 77-1-223-225, requires the Board of Land Commissioners to provide annual reports regarding the average return of revenue on asset value to trust beneficiaries of forested lands. This report is for forested lands classified by MCA 77-1-401 as Class 2 lands that are held in trust for the beneficiary. *"The report must include for each beneficiary:*

(1) the total acreage of forested land held in trust;
(2) a summary of the asset value of the forested tracts held in trust;
(3) a calculation of the average return of revenue on asset value for the forested tracts held in trust; and
(4) a listing by each department land office of the total acreage of forested land administered for the trust beneficiary and a calculation of the average return of revenue on asset value for lands designated to the trust beneficiary."

The *Report on Return on Asset Value by Trust and Land Office for State Trust Lands* is available upon request.

Table 25
Five-Year Summary of
Gross Revenue Generated (by Activity)

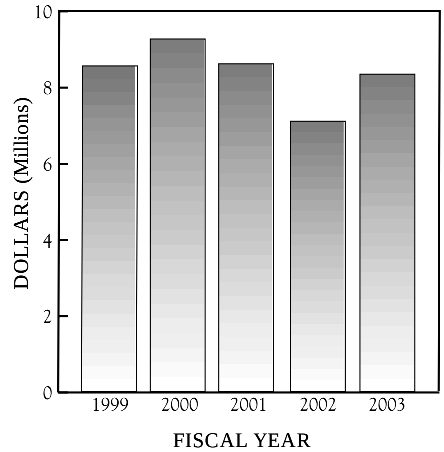
Activity	FY 1999	FY 2000	FY 2001	FY 2002	FY 2003
Agriculture and Grazing Management					
Grazing leases	$4,608,145	$4,494,637	$5,364,305	$6,047,838	$5,818,832
Agricultural leases	8,644,162	9,331,416	8,654,425	7,232,111	8,297,415
Totals	$13,252,307	$13,826,053	$14,018,730	$13,279,949	$14,116,247
Forest Management					
Timber sales	$5,905,196	$10,591,657	$6,596,578	$8,282,481	$6,915,128
Minerals Management					
Oil and gas revenues					
Rentals/bonuses/penalties	$2,083,626	$2,966,285	$3,098,515	$2,462,315	$2,402,510
Royalties	2,200,764	3,684,595	6,212,546	3,954,898	5,759,027
Seismic exploration	13,825	11,075	6,533	13,280	9,744
Aggregate minerals					
Rentals	250	250	600	400	175
Royalties	213,185	245,693	225,019	158,044	168,078
Coal					
Rentals/bonuses	44,371	44,371	6,261,360	45,810	43,897
Royalties	2,312,533	4,649,634	4,944,170	2,836,919	3,877,054
Other minerals					
Rentals/penalties	49,412	32,246	20,543	21,775	17,179
Royalties	8,439	8,878	8,079	7,813	4,984
Totals	$6,926,405	$11,643,027	$20,777,365	$9,501,254	$12,282,648
Special Use Management					
Rights-of-way	$157,231	$279,014	$218,456	$307,274	$189,078
Cabin and homesite leases	616,757	718,290	790,030	854,626	949,102
Land sales	254,917	261,884	0	15,954	19,744
Other leases and licenses	412,213	609,193	509,071	508,399	579,409
Recreational use					
General licenses	348,298	381,740	387,016	517,730	558,690
Special recreation use licenses	86,165	98,948	104,206	114,629	91,190
Totals	$1,875,581	$2,349,069	$2,008,779	$2,318,612	$2,387,213
Other					
Trust and legacy interest	$26,024,064	$25,620,337	$26,012,671	$29,661,124	$26,551,359
Other revenues	770,200	847,978	838,994	416,871	342,572
Totals	$26,794,264	$26,468,315	$26,851,665	$30,077,995	$26,893,931
TOTALS	$54,753,753	$64,878,121	$70,253,117	$63,460,291	$62,595,167

Agriculture and Grazing Management

The Agriculture and Grazing Management Bureau supervises the management and leasing of approximately 10,000 agreements for crop and rangeland uses on 4.65 million acres of school trust lands throughout the state. These duties are accomplished by administrative staff and specialists located in the department's Helena office and by staff located in field offices statewide.

Surface Leasing

Figure 22
Agricultural Revenue



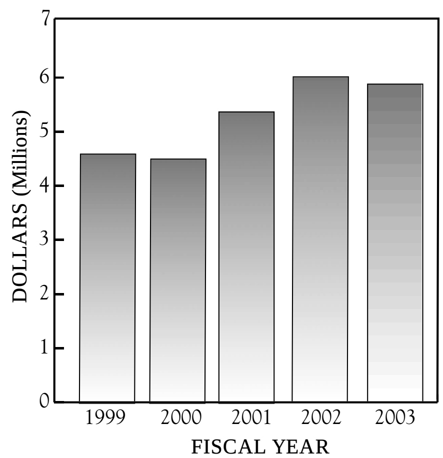
The program is responsible for the administrative functions associated with maintaining surface lease agreements. Each year, responsibilities include processing approximately 1,000 lease renewals; advertising, competitively bidding, and issuing approximately 50 new leases; reviewing and processing assignments, subleases, pasturing agreements, custom farming agreements, pledges, and mortgages; and collecting, verifying, and posting rentals and fees.

Agricultural Lands

Currently 3,000 agreements include agricultural use of state trust lands. Crops raised on these lands are primarily dryland hay and small grains, but also include irrigated grain crops, corn, sugar beets, potatoes, canola, safflower, alfalfa seed, and native grass seed.

In FY 2003, revenues totaling $8,297,415 were received from agricultural leasing (see Figure 22). The majority of the leases are on a crop-share basis with the minimum share of 25 percent set by statute. In addition to receiving rental payments from lessees, the state participates in and receives farm program payments from the U. S. Department of Agriculture (USDA) Farm Service Agency, as authorized under the Agricultural Market Transition Act of 1996. For FY 2003, this amount exceeded $2,700,000 for production flexibility contracts, lands enrolled in the Conservation Reserve Program (CRP), market loss assistance payments, and loan deficiency payments.

Figure 23
Grazing Revenue



Grazing Lands

Approximately 8,500 agreements include grazing use of trust lands. The 4.3 million acres of classified grazing lands and forestlands have an estimated carrying capacity of 1,110,000 animal unit months (AUMs). The minimum rental rate for grazing leases is set by a formula which includes the average weighted price for beef cattle sold in Montana during the previous year. In FY 2003, grazing leases generated $5,818,832 (see Figure 23).

Land Management

The program manages the agricultural and grazing resources on the lands administered by the bureau. This responsibility includes evaluation and assessment of range and cropland condition; compliance with the Montana Environmental Policy Act (MEPA); administration of archeological, paleontological, and historical properties on state trust land; investigations of lease noncompliance; participation in the Federal Farm Program; and oversight of water developments, water rights, and improvement projects such as range renovation and resource development.

Forest Management

The Forest Management Bureau oversees forested, state-owned trust lands to provide income to the various school trusts. Income is derived from the sale of forest products.

The bureau also provides program direction and support to the area land offices. Several resource management sections provide technical expertise.

- The Ecological Services Section provides guidance for forest land management, vegetation, and wildlife resources.
- The Watershed Resources Section provides expertise and direction for hydrology, soils, and fisheries.
- The Forest Inventory Section directs the collection of stand-level inventory and photo inventory data, provides assistance with timber cruising and forest data sampling, and operates the geographic information system (GIS).
- The Forest Product Sales Section oversees the timber sale program on all forested trust lands.

Support and program direction are offered in several different ways: developing resource management standards, conducting site-specific reviews, and formulating recommendations as members of interdisciplinary teams that develop land management proposals.

The area land offices have primary responsibility for on-the-ground management activities. With assistance from the Forest Management Bureau, they conduct environmental reviews of proposed management activities, prepare contracts for those activities, and complete the necessary field work.

The ***State Forest Land Management Plan*** (SFLMP), approved by the State Land Board in June 1996, guides the management of the forested trust lands. This guidance is provided in the form of general management philosophy and specific resource management standards. The strategic guidance provided by SFLMP is summarized in this excerpt:

> *Our premise is that the best way to produce long-term income for the trust is to manage intensively for healthy and biologically diverse forests. Our understanding is that a diverse forest is a stable forest that will produce the most reliable and highest long-term revenue stream. Healthy and biologically diverse forests would provide for sustained income from both timber and a variety of other uses. They would also help maintain stable trust income in the face of uncertainty regarding future resource values. In the foreseeable future timber management will continue to be our primary source of revenue and primary tool for achieving biodiversity objectives.*

In February 2003, the State Land Board approved new Forest Management Administrative Rules that provide programmatic direction for the Forest Management Program. These rules are written in support of the resource management standards contained within the ***State Forest Land Management Plan***. These new rules apply to all timber management activities initiated as of the date of acceptance of these rules by the State Land Board.

The 2003 Legislature directed the Forest Management Bureau to conduct a new sustained yield study. This study, to be conducted by a contracted third party, will review the annual sales target, which is currently determined to be 42.2 million board feet of timber. The purpose of the study will be to set a new annual timber sales target based on updated forest inventory information. This forest inventory information is more accurate and covers a broader area of the forested trust lands than the information used for the sustained yield study completed in 1996. The new study will be completed in the spring of 2004. During FY 2003 the annual sales target is set by statute to be 50 million board feet. This target is within the range of acceptable sales levels predicted and analyzed in the 1996 *State Forest Land Management Plan*. The new sales target, to be determined, will begin in FY 2004.

The Forest Management Bureau is in the process of developing a habitat conservation plan. This plan would cover a variety of listed species under the Endangered Species Act and may include other species currently listed in Montana as "sensitive species." The objective of this plan, developed in cooperation with the U.S. Fish and Wildlife Service, would be to provide habitat protection for the included species while providing for the continued Forest Management Program on forested trust land. This planning project will be completed in 2006.

Forest Improvement

The program uses fees from harvested timber to improve the health and productivity of trust forests. Uses of these fees authorized by statute include disposal of logging slash, reforestation, acquiring access and maintaining roads necessary for timber harvest, other treatments necessary to improve the condition and income potential of state forests, and compliance with other legal requirements associated with timber harvest. Specific activities include piling of logging slash, prescribed burning, site preparation, seed collection, seedling production, tree planting, thinning, genetic tree improvement, erosion control, and culvert replacement.

In FY 2003, the activities listed in Table 26 were undertaken to improve the health and productivity of forested state trust lands.

Table 26
Forest Improvement Activities in FY 2003

Plantation regeneration surveys	4,992 acres
Tree planting	1,184 acres
Tree browse prevention[1]	221 acres
Precommercial thinning	170 acres
Noxious weed spraying	2,000 acres
Herbicide application[2]	354 acres
Brush piling	448 acres
Pile burning	1,964 acres
Broadcast burning	170 acres
Tree improvement areas managed	13 acres
Road maintenance[3]	25 miles
Cone collection	412 bushels

1. Tree browse prevention includes replacing, maintaining, or removing seedling netting or applying a chemical repellent.
2. Herbicide application is associated with tree planting.
3. Road maintenance includes grading, snowplowing, bridge removal and upkeep, installing culverts, etc. Many of these activities do not lend themselves to reporting by miles.

Inventory

The program is responsible for the collection and analysis of forest resource inventory data in Montana. The program provides a current, comprehensive inventory of the timber resources on 720,160 acres of forested land administered by the Department of Natural Resources and Conservation. Stand-level inventory maps have been drawn and resource data collected for 1,215,450 forested and nonforested acres of state trust land. The development and maintenance of a geographic information system (GIS) used to support planning for forest management activities and environmental analyses is another responsibility of this program.

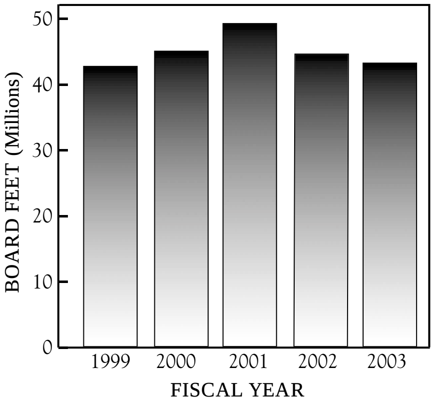
In FY 2003, the inventory program collected 52,200 acres of stand-level inventory data and added 700 new polygons to the photo-interpreted inventory database. The Fiscal Year 2003 statewide inventory updating process resulted in 2,100 updated polygons. A total of 7,200 polygons or approximately 202,000 acres were digitized to update the GIS map. A total of 7,200 records were entered into forest inventory databases. A total of 6,200 miles of roads were added, edited, or updated on the GIS road map.

Watershed Resources

The Watershed Resources Section provided technical assistance for hydrology, fisheries, and soils on 19 timber sales located throughout the state. The Watershed Resources Section assisted in the development of the recently promulgated Forest Management Administrative Rules pertaining to road management, watersheds, fisheries, grazing, and weed management. The section has been a principal in development of the proposed DNRC habitat conservation plan. The section also coordinated and conducted a comprehensive statewide watershed monitoring program. Specific monitoring accomplishments completed during FY 2003 include internal BMP audits of 12 DNRC timber harvests, surveys of several riparian restoration projects, and temperature monitoring of streams in Sula State Forest. A large soil monitoring effort was also completed for the Moose Fire Salvage and Reforestation Project on the Coal Creek State Forest. The section also initiated detailed fish passage assessments of existing stream-crossing structures located across the state.

Forest Product Sales

Figure 24
Timber Volume Sold



The program incorporates all activities and expenditures required to grow, harvest, and sell forest products from state trust lands efficiently. Activities within this program include field layout of timber sales; development of sale prescriptions; MEPA documentation; preparation of sale contracts, prospectuses, and notices; both field and office administration of timber sales; and sale billing and accounting. These responsibilities are shared among field foresters, area staff, and bureau staff.

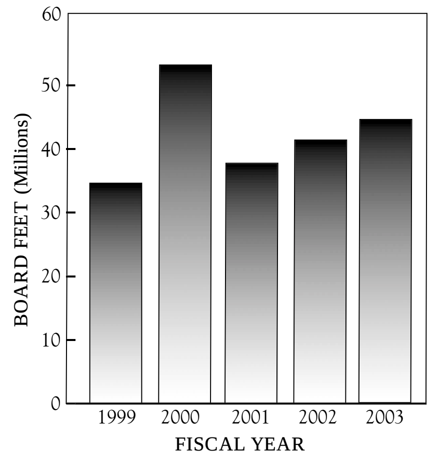
The estimated annual sustainable harvest from forested trust lands is 42.164 million board feet. That figure is the department's annual sales target, until the sustained yield study conducted in 1996 is revisited. Review is required at least once every 10 years, according to MCA 77-5-221-223. The target for FY 2003 was exceeded slightly due to wind throw salvage in the Swan State Forest.

In FY 2003, 26 timber sales were taken to and approved by the State Land Board for a total of 44.7 million board feet. The actual volume sold in FY 2003 was 43.0 million board feet (see Figure 24), which includes five timber sales that had been approved by the State Land Board prior to FY 2003.

During FY 2003, 44.5 million board feet of timber was harvested from state trust lands (see Figure 25), generating $6,915,128 in revenue (see Figure 26).

All timber sales and permits are developed, analyzed, and reviewed in the field by foresters and resource specialists to ensure that those sales comply with all applicable laws, policies, and management direction. At the end of FY 2003, DNRC had 64.2 million board feet under contract with an approximate value of $12 million.

Figure 25
Timber Volume Harvested



Minerals Management

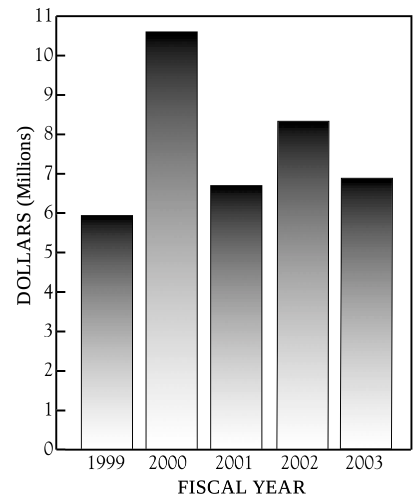
The Minerals Management Bureau is responsible for leasing, permitting, and managing approximately 2,928 oil and gas, metalliferous and non-metalliferous, coal, and sand and gravel agreements on 6.2 million acres of school trust land and more than 100,000 acres of other state-owned land throughout Montana.

General background information on bureau activities is available on the department's website:

www.dnrc.state.mt.us/trust/tlmdhome.htm

A calendar of key lease sale activities and dates is posted, and lease sale lists and sale results are available for viewing or downloading.

Figure 26
Timber Revenue Received



Mineral Leasing

The program is responsible for reviewing and processing all mineral lease and permit applications; advertising, competitively bidding, and issuing new leases; reviewing and approving lease assignments; and collecting, verifying, and posting lease rentals and production royalties.

Revenues received in FY 2003 are listed in Table 27 on the next page; the relative percentage derived from each mineral type is illustrated in Figure 27.

Figure 27
Total Mineral Revenue
by Mineral Type

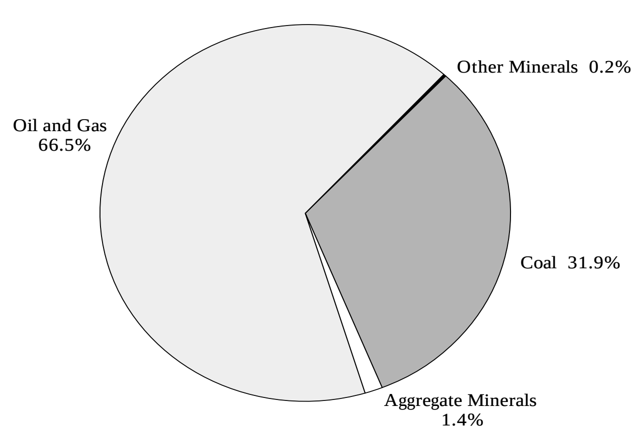


Table 27 Gross Revenues Received from Minerals in FY 2003		
Oil and Gas	Rentals/bonuses/penalties	$2,402,510
	Royalties	5,759,027
	Seismic exploration	9,744
Aggregate Minerals	Rentals	175
	Royalties	168,078
Coal	Rentals/bonuses	43,897
	Royalties	3,877,054
Other Minerals	Rentals/penalties	17,179
	Royalties	4,984
	TOTAL	$12,282,648

Figure 28. Oil and Gas Revenue (excluding Seismic Exploration)

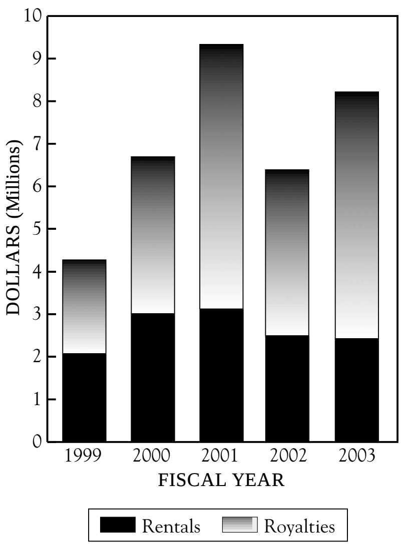
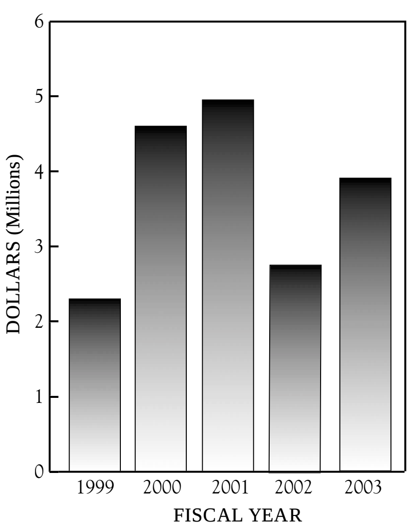


Figure 29
Coal Royalties



Oil and Gas Leasing

The program is responsible for the leasing and monitoring of 2,795 oil and gas leases, 551 of which are currently productive. The number of oil and gas leases managed is up 1.6 percent, while the number of currently producing leases increased by 1.7 percent, compared to FY 2002. Activities related to existing leases include collecting, verifying, and posting rental, royalty, delay drilling, and shut-in payments; reviewing and approving assignments and tracking working interest ownership; reviewing and preparing for approval communitization agreements and unit operating agreements; and coordinating with field offices the review and approval of all proposed physical operations on state leases. In addition, four oral auctions of new oil and gas leases are prepared and conducted each year.

In FY 2003, 1,017,464 barrels of oil were produced; 5,380,950 MCF of gas and 486,979 gallons of condensate were also produced. Revenues received over the last five fiscal years are shown in Figure 28. Oil production increased 11.7 percent from FY 2002. However, the increase in average price from $19.53 per barrel in FY 2002 to $26.90 per barrel in FY 2003 accounted for the majority of the significant increase in oil royalty revenue. Gas production in FY 2003 decreased 8.7 percent, while the price increased 52 percent, compared to FY 2002, which resulted in a significant increase in royalty revenue.

Other Mineral Leasing

The program also administers a wide variety of leases—including metalliferous and non-metalliferous leases, coal leases, gravel permits, and land use licenses for non-mechanized prospecting—for all other mineral activity on state trust land. Royalties from coal increased 37 percent compared to FY 2002, while the average price per ton decreased 26 percent. In FY 2003, 3,494,901 tons were mined, which is a 90 percent increase over FY 2002. The volume mined can vary significantly from year to year, as mining activity moves onto or off state land within the normal sequence of mining operations. A five-year summary of coal royalties is shown in Figure 29. Royalties and rentals are also collected for minerals such as bentonite, clay, gold and associated minerals, peat, and shale.

SB 495 (Coal Tax Trust Loan) Implementation

The 2001 Legislature passed SB 495, which authorized the department to borrow from the Coal Severance Tax Trust Fund and place the loan proceeds in the Common School Permanent Fund in lieu of up to 30 years of net future mineral royalties. Instead of being deposited into the permanent fund, these mineral royalties will be utilized to pay back the loan, with any remaining surplus distributed to the Office of Public Instruction for school equalization. The Board of Land Commissioners reviewed the legislation and directed the department to implement the provisions of SB 495 beginning in Fiscal Year 2002.

The SB 495 fiscal note included an estimate that the department would receive approximately $138.9 million in net mineral royalties over the next 30 years. Using a discount rate of 9.85 percent produced an equivalent present (i.e., loan) value of approximately $46.4 million. Effective July 1, 2001, the department borrowed $46,366,904 from the Coal Severance Tax Trust Fund and placed it in the Common School Permanent Fund. Net mineral royalties received since July 1, 2001, have been redirected to cover loan costs, with the remainder going to school equalization. The annual and cumulative effects on both the school equalization account and the Common School Permanent Fund are summarized in Table 28.

Table 28
Implementation of Loan from
Coal Severance Tax Trust Fund

Loan Year	Fiscal Year	Net Mineral Royalties[2] (millions)	Loan Repayment: Principal[3] (millions)	Loan Repayment: Interest (millions)	Incremental Effects[1]: School Equalization[4] (millions)	Incremental Effects[1]: Common School Permanent Fund (millions)
1	2002	$3.654	0	$3.370	+$3.234	+$42.867
2	2003	6.101	0	3.307	+5.285	(-5.970)
Cumulative Effects						
Fiscal Year-End 2003		9.755	0	6.677	+8.519	+36.897
End of Loan (est.)		138.894	46.367	55.767	(-12.178)	(-93.229)

1. The amounts in these columns are the changes in the amounts generated for school equalization and the permanent fund that result from the implementation of SB 495.
2. A pro rata portion of the gross mineral royalties contribute to funding of the Trust Administration Account.
3. SB 495 specified loan payments of interest only during Fiscal Years 2002 and 2003. Therefore, the 2003 fiscal year-end loan obligation remains $46,366,904. Commencing in Fiscal Year 2004, mineral royalties will be obligated to pay both principal and interest on the loan, with any remainder distributed to school equalization.
4. Includes additional interest earned and distributed from the incremental permanent fund balance.

On April 24, 2002, a lawsuit was filed against the State by MonTRUST (Montanans for Responsible Use of the School Trust). MonTRUST is a nonprofit citizens' organization whose purpose is to promote the protection, advancement, and appropriate use of Montana's school trust lands on behalf of their trust beneficiaries. The lawsuit alleged that SB 495 violated trust duties, and that the State's handling of trust revenues violated the Constitution and the Enabling Act. On June 23, 2003, the State district court ruled in favor of the State on all counts. On October 23, 2003, MonTRUST filed an appeal to the Montana Supreme Court. That appeal is pending.

Royalty Auditing and Accounting

The program provides additional revenue to the school trusts through programmatic audits. The program identifies royalty under- and over-reporting, rectifies discrepancies, and raises the level of voluntary compliance.

Audit activity increased in FY 2003 and continued to reflect improved levels of compliance. Five audits were closed out, including a large settlement with Shell Oil Company resolving issues in dispute since the early 1980s. Collections for all audit assessments totaled $903,599. Seven audits are currently open and pending from FY 2002, with one preliminary assessment due.

Abandoned Well Reclamation

The Board of Oil and Gas Conservation (BOGC) has regulatory and bonding authority on oil and gas wells in Montana, including those wells on state trust lands. BOGC seeks funding from the Reclamation and Development Grants Program, administered by DNRC's Conservation and Resource Development Division, to reclaim wells where there is inadequate bonding or no responsible party. The Minerals Management Bureau works with BOGC staff to integrate problem wells on state trust land into BOGC's grant requests.

Riverbed Leasing

The Minerals Management Bureau continues its efforts to clarify title to the beds and islands of navigable rivers. Pursuant to statute, the state owns those lands below the low-water mark, islands and their accretions formed in the riverbeds after statehood, and abandoned channels formed by avulsion. Because two navigable rivers in Montana flow through areas with major oil and gas resources, the department has conducted numerous riverbed studies to determine and document state ownership of land. This process allows the state to take a progressive position in issues involving substantial royalties.

In FY 2003, the state received $296,984 in oil and gas revenues from leased riverbed tracts. Other mineral leasing activity provided $2,051 from riverbed tracts.

This same ownership review process is also becoming increasingly important in areas where surface development and/or use encounters beds, islands, and abandoned channels of navigable rivers. The department continues to work with state, federal, and private entities whenever ownership issues arise.

McDonald Mine Proposal

In November 1994, the Seven-Up Pete Joint Venture (SUPJV) submitted a mine operation and reclamation plan to the Montana Department of Environmental Quality (DEQ) and DNRC for review. The proposed open-pit gold mine was to be located near the town of Lincoln in Lewis and Clark County and included both private and state school trust lands. Preparation of a joint environmental impact statement (EIS) then commenced, with DEQ, DNRC, and the U.S. Army Corps of Engineers serving as the co-lead agencies.

In July 1998, DEQ issued a stop-work order on the preparation of the EIS because SUPJV had not paid invoiced amounts due. SUPJV subsequently brought its EIS account current with DEQ, but did not fund any further EIS work. In September 1998, DNRC advised SUPJV that the remaining primary term of the mineral leases had resumed running because no EIS review work was taking place. DNRC further advised that, unless the EIS review process recommenced, the state mineral leases would expire when their remaining primary terms ran out in February 2000. In October 1998, SUPJV filed suit against DNRC, asserting that the leases would not expire. SUPJV subsequently withdrew that lawsuit.

In November 1998, a state initiative (I-137) passed that prohibits new open-pit mines that utilize cyanide heap leaching.

In July 1999, mine opponents filed suit against the State Land Board and DNRC, seeking a judicial determination that the mineral leases had already expired. In February 2000, DNRC notified SUPJV that the state school trust mineral leases had now reached the end of their primary term and expired. This determination was upheld on administrative appeal. SUPJV amended its previously filed lawsuit against the State of Montana to include a challenge to this administrative determination. That lawsuit also alleges that 1-137 constitutes a taking of property rights held by SUPJV.

On December 9, 2002, the First Judicial District Court dismissed all counts in SUPJV's lawsuit against the State of Montana. SUPJV filed an appeal to the Montana State Supreme Court in January 2003. That appeal is pending.

Special Use Management

The Special Use Management Bureau administers all activities on lands classified as "other" and all secondary activities on lands classified as grazing, agriculture, or timber. The bureau's Real Estate Services Section is responsible for sales, exchanges, and grants associated with management of 5.1 million acres. The Right-of-Way Section manages the disposition of rights-of-way. The Property Management Section manages the Leasing Program and formulates a programmatic plan for the development of special uses on trust lands. The Leasing Program includes commercial developments, new leases such as wind farms, existing homesite leases, and short-term land use and recreation licenses. The bureau is also responsible for assisting other agencies with the management of their land. MCA 77-2-351 allows the state to transfer non-trust lands to local governments for a commitment that the property be used for a continuing public purpose.

The 2003 Legislature passed Senate Bill 137, which provides clear authority for the issuance of leases for commercial purposes. Amoung its provisions, the law allows the department to issue a commercial lease for up to 99 years; set a minimum annual rental rate at 2 percentage points below the rate of return of the Unified Investment Program administered by the Montana Board of Investments multiplied by the appraised value; utilize up to 10 percent of the annual rentals received for property management and administrative matters related to the leases such as realtor's fees, engineering, surveying, etc.; issue a two-year lease option to preserve the optionee's sole and exclusive right to obtain a commercial lease at a future time; and allow credit against the annual rental accrued for payments made on behalf of the state by the lessee for special improvement district assessments, annexation fees, etc.

The sources of FY 2003 special use revenue are summarized in Table 29, and each is shown as a percentage of the total special use revenue in Figure 30. Income from special uses over the last five years is illustrated in Figure 31.

Table 29
Special Use Revenues in Fiscal Year 2003

Cabinsite and homesite leasing	$ 949,102
Land sales	19,744
Easements	189,078
Special use leases and licences	579,409
Recreational use	649,880
TOTAL	$2,387,213

Figure 30. Special Use Revenue by Source in FY 2003

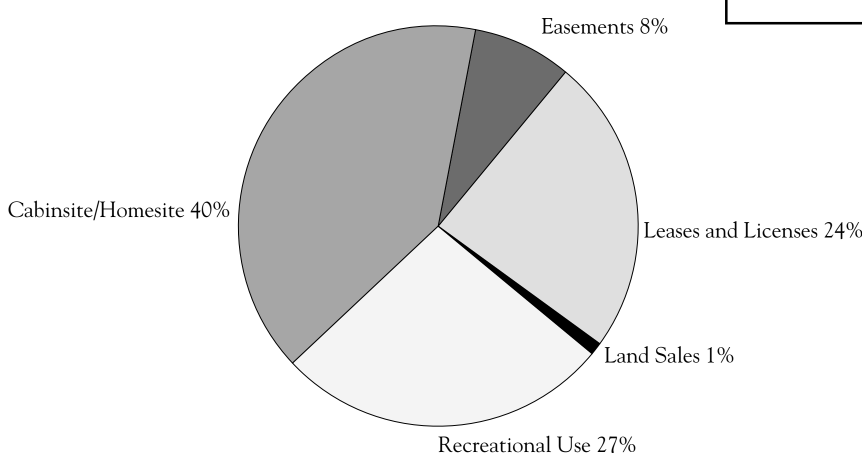
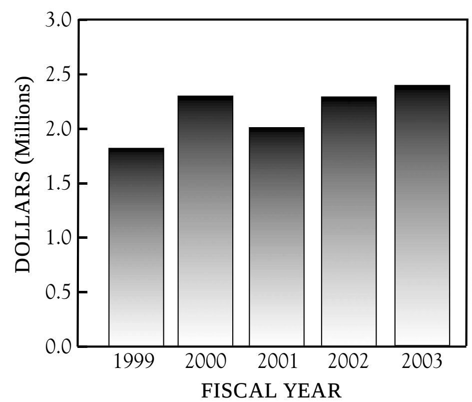


Figure 31. Special Use Revenues FY 1999 to FY 2003



Leasing/Licensing

The Property Management Section is actively planning and developing tracts of land with high potential for cabinsite, single- and multi-family residential, and commercial leases. Commercial development of trust land in urban areas has the possibility of increasing revenues over a million dollars over the next five years. Additionally, the section has solicited for and received proposals for the development of wind energy on trust lands.

Lewis and Clark Subdivision — Bozeman

The 12-lot, 33-acre subdivision in Bozeman is a promising development. The property has Interstate 90 frontage between the 7th Street and the 19th Street interchanges. The 19th Street corridor is flourishing with commercial and industrial development. The infrastructure and the development of the first lot, with a state office building, began in April 2003.

Spring Prairie Center— Kalispell

This parcel, adjacent to Kalispell, has been annexed into the City of Kalispell and zoned with a Planned Unit Development agreement. Infrastructure is now available to begin future development of the property. Home Depot and Target have been developed across the highway from the parcel. This property has promise for retail, commercial, professional, and residential development. The department solicited for development proposals for commercial uses for the land adjacent to Highway 93. The department received several responses and is in the process of negotiating a long-term ground lease on approximately 13 acres with an option to lease 47 additional acres. A Lowe's Home Improvement Store is slated to be the anchor tenant for the first of three phases of development. Future phases may include a multi-screen theatre and several national-name tenants.

14th Street Northwest — Great Falls

The department bid and issued a long-term lease for the development of a Hampton Inn on approximately 3.78 acres across from Marketplace Mall in Great Falls. This property is triangular in shape along 14th Street Northwest at the new interchange. The Hampton Inn opened for business in May 2003.

Continental Divide — Billings

Phase I of this property, which totals more than 300 acres, has been subdivided into residential lots and sold. Single- and multi-family residential and commercial uses are intended for this property. A landscape plan has identified a theme for the property, which will incorporate a trail system, a park, and a greenbelt to preserve native trees.

Whitefish Area Plan

Trust lands within the greater Whitefish area have historically been managed for timber and agricultural uses, while the surrounding community's demographics and economy have significantly changed. The department's goal is to manage trust lands to serve the surrounding community better, while increasing revenue to the trust. In association with the City of Whitefish and Flathead County's updating their Growth Policy, the department has developed a neighborhood plan for approximately 13,000 acres within 5 miles of Whitefish. The Whitefish Area Plan will attempt to bring together the needs of the trust beneficiaries and the needs of the surrounding community.

Programmatic Plan

The bureau is in the process of developing a programmatic environmental impact statement to guide the department in the use of trust lands for commercial, industrial, recreational, open space, and wildlife habitat purposes.

Exchanges

The department reviews and processes land exchanges for the State Land Board under a land exchange policy that was developed a few years ago. Land exchanges are analyzed using the base criteria listed on the following page.

- Equal or greater land value
- Similar navigable lake or stream values
- Equal or greater income to the school trust
- Equal or greater acreage
- Consolidation of state trust lands
- Potential for long-term appreciation
- Improved or equal access to state or public lands

In FY 2003, the bureau received three new applications and supported seven land exchanges in association with the field offices. One land exchange was completed in FY 2003.

Land Sales and Acquisition

One lot in the Continental Divide Subdivision in the Billings area was sold during FY 2003. This was the last lot intended to be sold in the first phase of the development of the Skyview Ridge property.

The 2003 Legislature passed House Bill 223, which enables the Board of Land Commissioners to sell and purchase parcels of state trust land so as to:

- Prudently increase the revenue-generating capacity of state trust lands
- Diversify trust holdings and reduce the number of isolated parcels
- Make management of state trust lands more efficient
- Protect the corpus of the trust from any devaluation or loss
- When consistent with the fiduciary duties, increase legal accessibility and public access to state lands
- Minimize impacts to an individual county's tax base
- Maintain, as closely as possible, the exiting land base of each trust

Rules to implement the Land Banking Program are being developed and will be completed in 2004. Information about the program will be available upon rule completion. To obtain information regarding land banking, please send your name and mailing address to:

Land Banking
Department of Natural Resources and Conservation
P.O. Box 201601
Helena, MT 59620-1601

Information is available at:

www.dnrc.state.mt.us/trust/tlmdhome.htm

Land Transfers

As the central depository for ownership records of non-trust state lands owned by other agencies (except lands owned by DFWP and the Montana Department of Transportation), DNRC is responsible for establishing and maintaining a filing system for information about these state lands. The department is working with the other agencies to establish a database system that will serve as an ownership database for other agencies.

The State Land Board has authority over the disposition of properties and has the ability to sell, lease, or exchange property when it is advantageous to the state, as provided in MCA 77-1-204(2). In 1995, the Legislature passed MCA 77-2-351, which allows the state to transfer non-trust state land to a public entity in return for a commitment that the property will be used to provide a community service or a benefit that fulfills a public purpose. In FY 2003, the department processed the transfer of five state-owned properties as follows.

- The Department of Corrections transferred approximately 219 acres to the City of Deer Lodge/County of Powell for airport expansion.
- The Department of Public Health and Human Services transferred 160 acres to DNRC for possible leasing.
- The Department of Labor and Industry transferred a building and city lot to Toole County for additional office space.
- The Montana Heritage Preservation and Development Commission transferred an easement to Virginia City as part of a new wastewater pipeline, replacing an antiquated system.
- The Department of Corrections returned a 130-acre easement to the City of Deer Lodge/County of Powell in exchange for a new easement on the building and property actually being used by the Department of Corrections.

Recreational Use

The Recreational Use Program was established by the 1991 Legislature. Legally accessible state trust lands may be used for recreational activities by persons who hold state land recreational use licenses, provided the lands are not closed or restricted for such use by rule or by the department. The type of license required depends on the type of activity conducted. Licenses for "general" recreational use — which, with a few exceptions, includes most forms of noncommercial and nonconcentrated recreational activities—can be purchased from all Montana Department of Fish, Wildlife and Parks license agents and DNRC area offices. "Special" recreational use licenses, which are available only from DNRC area offices, are required for concentrated recreational use conducted by groups or organizations, or for commercial activities such as outfitting. In FY 2003, 50,795 general recreational use licenses were sold.

The 2003 Legislature passed Senate Bill 130, which changed the licensing structure of general recreational use. Beginning March 2004, use of state trust lands for hunting, fishing, and trapping will be assessed under the wildlife conservation license. A $2.00 fee will be added to that license for those recreational uses. All other uses of trust lands will be allowed under the existing general recreational use licensing process.

The department projects that revenues from general recreational use license fees will increase to over $800,000 annually as a result of this legislation.

Rights-of-Way

The bureau is responsible for reviewing and processing applications for rights-of-way and easements across surface lands and navigable waterways administered by the state. Rights-of-way are most commonly sought for utility lines, pipelines, and roads.

In FY 2003, the bureau received approximately 300 new applications for historic rights-of-way. Under the historic rights-of-way program, utility companies, counties, and private landowners may apply for permanent easements for historic utilities and access roads that were constructed on state trust lands prior to 1997 without the benefit of a legal easement. Applications for historic uses that occurred on state land must be submitted by October 1, 2006. The bureau initially anticipated approximately 100 historic right-of-way applications per year. The increase in applications is due to several utility companies and one county deciding to resolve their trespass situations within the first two years of the program.

The bureau processed approximately 112 applications for new easement installations and 15 assignment requests in FY 2003. A total of 375 applications was presented to the State Land Board. Revenue for rights-of-way in FY 2003 totaled $189,078.